

# OUTLOOK

*A Monthly Forecast for the Economy and Real Estate*



## FORECAST SUMMARY

- Recent indicators of the economy's health suggest that, at present, this economic expansion is still going strong. Reports on economic activity in the opening month of 1989 included substantial increases in employment, retail sales, housing starts and industrial production.
- While indicators point towards continued economic growth, the chances for a steady rise in the rate of inflation are also growing. Prices at the wholesale level rose 12.7 percent at an annual rate in January, accompanied by a 7.2 percent increase in the consumer price index, taken at an annual rate.
- Financial markets looked to the Federal Reserve for reassurance on its own commitment to control inflation. In response, the Fed forced the federal funds rate up by almost 3/4 of a percentage point to 9.75 percent and raised the discount rate to 7 percent from 6.5 percent.
- Housing starts jumped 8 percent in January to a seasonally adjusted annual rate of 1.693 million units, the fastest rate since March of 1987. Single-family starts climbed 7.1 percent to a seasonally adjusted annual rate of 1.203 million units, while multi-family starts were up 10.1 percent to a seasonally adjusted annual rate of 490 thousand units.
- Sales of new single-family homes reached an annual rate of 669 thousand units in December, up slightly from the November rate of 665 thousand units, and 14.2 percent faster than the 586 thousand unit pace of one year ago.
- Sales of existing single-family homes took a breather in January, slowing to a seasonally adjusted annual rate of 3.63 million units, or 7.4 percent below the December annual rate of 3.92 million units.
- The January median existing single-family home price rose to \$91,500, a 3.6 percent increase from the December median price of \$88,700. However, even with this sizable monthly increase, the January median price was just 3.9 percent above January 1988, reflecting the modest increase in home prices during 1988.

## IN THIS ISSUE



Forecasting & Policy Analysis Division  
NATIONAL ASSOCIATION OF REALTORS®

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# THE SPRING OF OUR DISCONTENT

## Economic Commentary

by

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March is a wonderful month. In many--if not most--parts of the country the grip of winter gives way to the gentler caress of warmer weather. In Florida and California, Spring is officially ushered in by the crack of bat and the thud of ball on glove. Most of all, the entire month is given over to that greatest of all sporting events, the NCAA basketball tournament. In the words of the commercial, "It doesn't get any better than this."

Unless, of course, you operate in a business that is affected by interest rate movements. In this particular Spring, the warmest weather will be in financial markets where the Federal Reserve is steadily pushing interest rates upward in its crusade to keep the inflation dragon in its cave. It seems that for most of the fall, and into the winter, Chairman Greenspan has been using his bully pulpit to preach of the evils of inflation and how those evils are looming ever larger in this growing economy. And he was right. But like the prophet in his own country, his message was not given nearly the weight it deserved.

Now, however, the voice is coming through loud and clear. Two prime rate increases and one discount rate rise in the course of two weeks have hit the economy upside the head and banged in the old-time religion. The result is that the recent increases in interest rates will continue through most of the Spring, and will have a retarding effect on what is an otherwise strong housing market.

Three questions need to be asked. First of all, are the Fed's recent actions justified? Like all good economic questions, this one can be answered yes and no. It now appears that the economy was expanding much too rapidly at the end of 1988. In the seventh year of an expansion, with our low rates of savings and investment and the pressures on plant and equipment that have been building up, increased inflation was almost inevitable. January's price figures, although biased by the drought of last summer, verified this. But like the generals who fight the last war, the Federal Reserve Board's actions may be a bit late. Financial markets realized the danger of increased inflation at least six weeks before the increase in the discount rate, and acted to slow the economy on their own. Thus, the Fed's action has the effect of punctuating the sentence rather than being its predicate.

The second question deals with the appropriateness of the Fed's policy in general. Specifically, is the Fed inexorably pushing this economy into recession? The answer here is no. While it has been restrictive in its policy stance, the Fed has acted slowly and incrementally. It has done nothing in such large measure that it cannot pull back. Our view of the economy is that the Fed will have realized that it was successful by May of this year, and will begin to pull back, thus easing interest rates. There is no recession in the cards for 1989, although, we will see the growth rate drop into the 2.5 percent area.

The final question deals with the housing sector. Will this rate rise kill off the 1989 market? It's inevitable that the rise in interest rate will push some buyers out of the market. But there really is a tug of war going on here. The demographics of housing right now are extraordinary. In most parts of the country, the number of customers in the market is quite pleasant. But pulling against that demand will be the interest rate hit to affordability. This arrangement is far from unusual--in fact, a market in which the struggle does not take place is the exception.

In 1988, the demographics won, and resales reached their highest point of the eighties. For 1989, we're looking (at least in the first half of the year) for at best a stalemate. The numbers we will see for resales will be strong, but not nearly what they were in 1988. January's home sales numbers illustrate the nature of this year. The national totals were down more than seven percent from December's pace, but are up more than thirteen percent from January 1988. As the year progresses, we will see more month to month declines, but smaller margins over last year's pace. Finally, and quite paradoxically, the home sales figures for the second half of the year, after interest rates have stabilized, will be up from the first half of the year, but below 1988.

For most REALTORS®, all this sums up to a case of lost potential. When all is said and done, 1989 will be an OK year. The shame of it all is that but for the interest rate rise that we are now living through, it could have been an outstanding one. But, this is the seventh year of the housing expansion, and aging robs many of us our potential. As the philosophers have written, "What a drag it is gettin' old."

# Outlook for the Economy and Real Estate

## THE ECONOMIC OUTLOOK

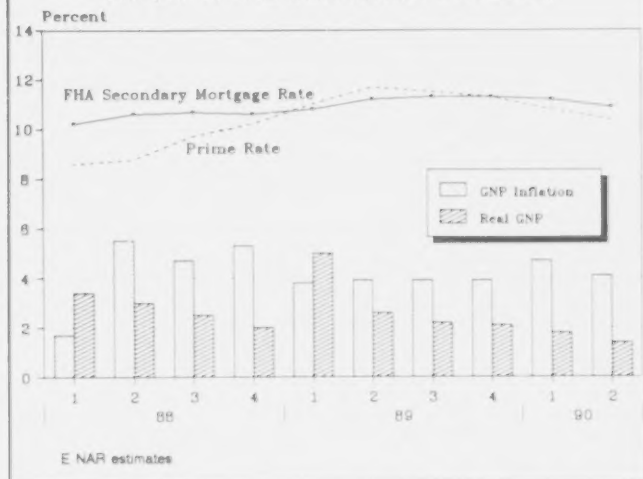
The recent revision by the U.S. Department of Commerce to its original estimate of 1988 fourth quarter real GNP growth reveals some important changes in the forces shaping economic growth. While the annual rate of growth remained at 2.0 percent, the revision raised the estimate for consumption expenditures to \$22.2 billion and lowered its estimate of net export (exports-imports) growth to a negative \$9.8 billion: these figures were originally reported as \$18.1 billion and negative \$6.8 billion, respectively. These new figures ran counter to the hopes of many economists who had expected that consumption growth would yield to export growth, thereby paving the way for a gradual economic slowdown or "soft landing." However, more recent indicators of the economy's health suggest that, at present, this economic expansion is still going strong. Reports on economic activity in the opening month of 1989 included substantial increases in employment, retail sales, housing starts and industrial production.

### Higher Prices on the Horizon

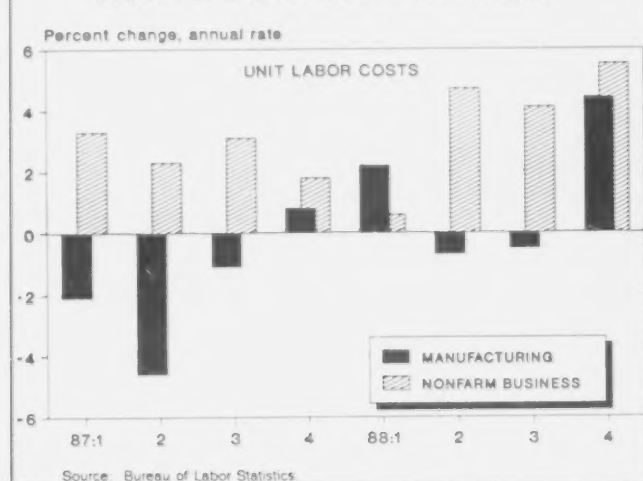
While indicators point towards continued economic growth, the chances for a steady rise in the rate of inflation are also growing. For several years, modest wage increases have helped keep inflation in check despite strong economic growth. However, the production report for the fourth quarter of 1988 showed that even without higher wage demands, labor costs are indeed rising. While non-farm businesses responded to strong domestic and foreign demand by increasing output at a 3.6 percent annual rate, capacity constraints made it difficult to expand productivity (output per hours worked), which remained unchanged in the fourth quarter. As a result, those firms which increased production were forced, in many cases, to hire on new employees, leading to a 3.2 percent annual growth rate in employment. In the near term, production costs will rise if productivity gains fall significantly behind those for wages. The recent data shows unit labor costs surging ahead in the last quarter of 1988, jumping 5.5 percent in the non-farm business sector and 4.4 percent in the manufacturing industries.

On the heels of this rise in unit labor costs, came a record leap in the producer price index. Prices at the wholesale level rose 1.0 percent in January, which translates into a 12.7 percent annual increase, marking the largest gain in producer prices in over three years. Admittedly, rising food and energy costs explained a large part of the price hike, but price increases of over 1 percent also hit books, passenger cars, jewelry, and children's goods. Rising producer prices generally are thought to indicate future inflation at the consumer level, as higher prices are passed from wholesaler to retailer to consumer. Consumer prices rose 7.2 percent at an annual rate in January, compared with annual rates of 3.7 and 4.1 percent in 1987 and 1988, respectively. The increase in the price index extended beyond the traditionally, volatile sectors: consumer prices rose 6.0 percent excluding food and energy.

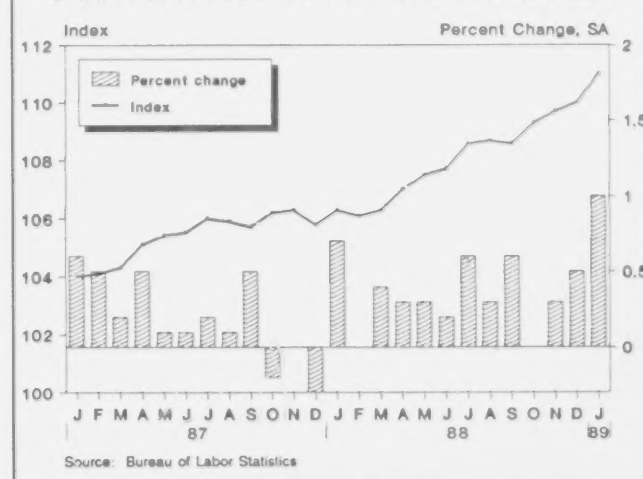
GRAPH 1: THE ECONOMIC OUTLOOK



GRAPH 2: LABOR COSTS ARE RISING



GRAPH 3: PRICES SURGE AHEAD IN JANUARY



## Monetary Policy and Interest Rates

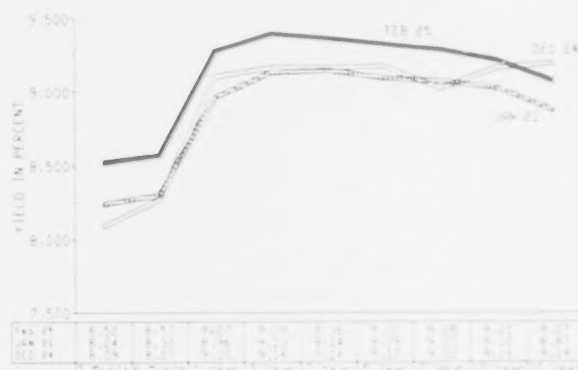
These recent indications of accelerating inflation have been aggravated somewhat by instability in the dollar and concerns over OPEC's new determination to raise oil prices. In light of these developments, financial markets have looked to the Fed for reassurances of its own resolve in the fight to control inflation. The Fed has been eager to demonstrate its resolve, pushing short-term interest rates up more than 300 basis points in recent months. In February alone, the Fed forced rates higher by muscling up the federal funds rate almost 3/4 of a percentage point higher to 9.75 percent. Over the course of this recent tightening, major banks responded by twice raising the prime rate by one-half a percent until it reached 11.5 percent. After months of credit tightening, the Fed finally raised the discount rate to 7 percent from 6.5 percent. The discount rate, which is the rate the Fed charges on overnight loans to banks, is considered one of the Fed's most powerful policy tools due to its status as lender of last resort. However, banks have become increasingly reluctant to borrow from the Fed and, with the spread between the federal funds rate and the discount rate remaining at almost 300 basis points, the Fed's latest discount rate hike will have little real effect on credit. More important, was the message behind the rate increase which was intended to underline the permanence of the Fed's commitment to a tighter credit policy and lower inflation. We do not expect to see any aggressive credit tightening in the near future, as financial markets and the Fed wait to see the effects of their latest efforts. Consequently, any substantial fall in interest rates during the remainder of 1989 is not likely. Instead, mortgage rates will hover between 11 and 11.5 percent before falling in 1990. Any interest rate forecast is borne of assumptions about economic growth, but the additional uncertainties of how a new President will work with Congress to address such weighty issues as the budget & trade deficits, the FSLIC bailout and international economic cooperation, add considerable risks to this forecast.

## REAL ESTATE MARKETS

### Housing Starts

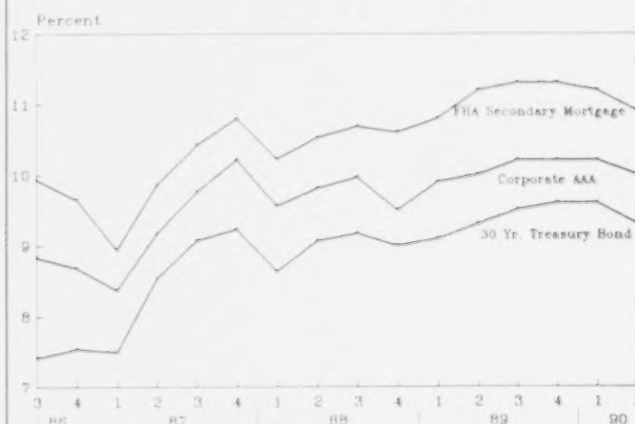
Encouraged by unseasonably warm weather and the remarkably fast pace of existing home sales during December, housing starts jumped 8 percent in January to a seasonally adjusted annual rate of 1.693 million units, the fastest rate since March of 1987. Single-family starts climbed 7.1 percent to a seasonally adjusted annual rate of 1.203 million units in January, their fastest rate in over 14 months, and 17.8 percent faster than a year ago. Multi-family starts were up 10.1 percent to a seasonally adjusted annual rate of 490 thousand units, 32.4 percent higher than the 370 thousand unit rate of a year ago. Housing starts are not expected to continue at their present rate. Rather, they are expected to yield to higher interest rates, slowing to a rate of 1.43 million units for most of 1989, and remaining at about 1.41 million units in 1990.

GRAPH 4: THE YIELD CURVE



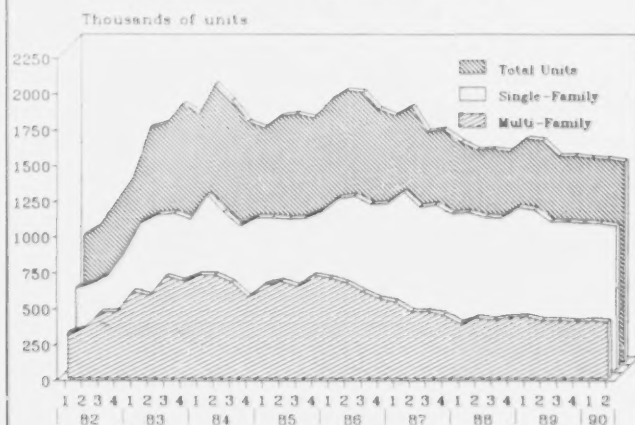
Source: The Federal Reserve Board

GRAPH 5: LONG-TERM INTEREST RATES



Source: The Federal Reserve Board

GRAPH 6: HOUSING STARTS



Source: The Bureau of Census, ENR estimates

### New Home Sales

Sales of new single-family homes reached an annual rate of 669 thousand units in December, up slightly from the November rate of 665 thousand units, and 14.2 percent faster than the 586 thousand unit pace of one year ago. While new home sales began 1988 at the relatively slow annual pace of 579 thousand units, sales climbed to finish 1988 with a total of 677 thousand new homes sold, just above the 1987 total of 671 thousand new homes. The continued strong demand for new homes, despite higher interest rates and the prospects for slower economic growth, helped to raise the median price of a new home by 7.7 percent during 1988, and encouraged housing starts throughout the year. This demand, however, is expected to yield to less favorable economic conditions in 1989, leading to an 4.7 percent drop in sales to a total of 645 thousand homes.

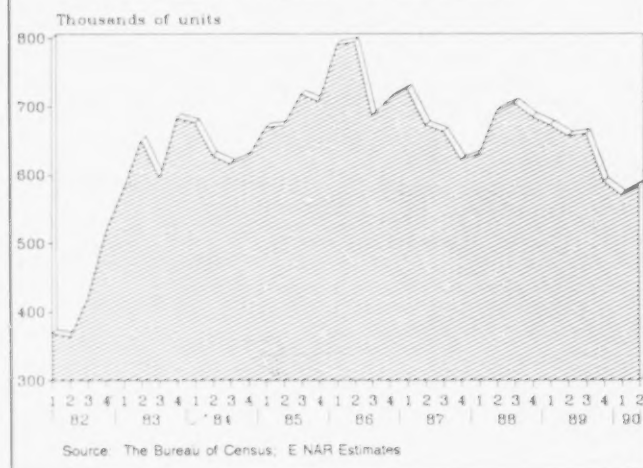
### Existing Home Sales

Sales of existing single-family homes took a breather in January, slowing to a seasonally adjusted annual rate of 3.63 million units, or 7.4 percent below the December annual rate of 3.92 million units. The December rate had been fueled partly by an inventory clearance in the Southern market. A return to a more "normal" sales pace in the South caused most of the national decline in existing home sales during January. The January rate was, however, exceptionally strong in its own right, as illustrated by the 13.4 percent increase over the January 1988 sales rate of 3.2 million units. The outlook for existing single-family home sales over the next year is reasonably bright, despite the expected rise in mortgage interest rates. Rising interest rates on both fixed and adjustable rate mortgages are expected to slow the housing market in the coming months. However, the wide acceptance of ARM's will continue to provide potential homebuyers with the means to purchase homes that would be otherwise unaffordable with a fixed rate mortgage. The sales pace of existing single-family homes will likely reach an average annual rate of 3.56 million units in the present quarter, and likely quicken in the coming peak sales season to an annual rate of about 3.68 million units. Total sales are expected to remain almost even with 1988, totaling 3.58 million units in 1989.

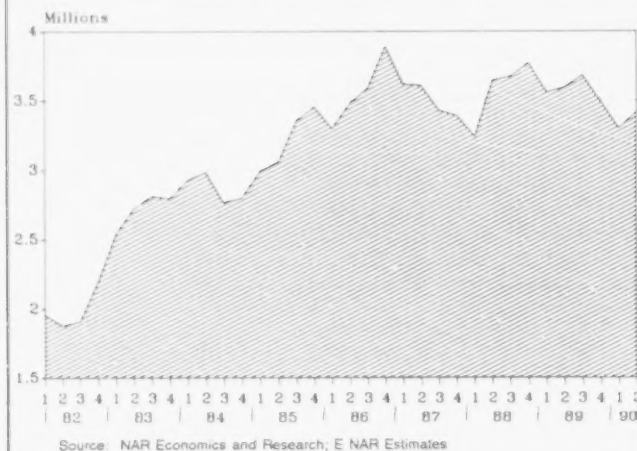
### Home prices

The January median existing single-family home price rose to \$91,500, a 3.6 percent increase from the December median price of \$88,700. However, even with this sizable monthly increase, the January median price was just 3.9 percent above January 1988, reflecting the modest increase in home prices during 1988. The upward pressure on prices in January came mainly from the South where prices rose 8.3 percent to \$84,700 from its December low of \$78,000. Prices also rose by 1.9 percent in the West to \$131,100 (up 9.9 percent over 1988), and 2.2 percent in the Midwest to \$69,000 (up 2.1 percent over 1988). In the Northeast, after rising 1.6 percent in December, the median existing home price fell 1.3 percent in January to \$141,100.

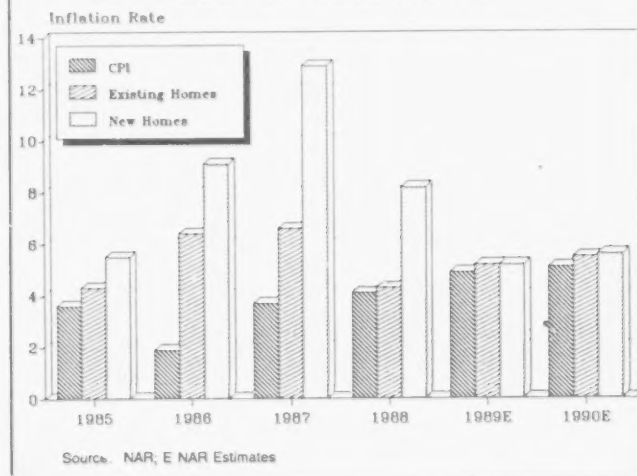
GRAPH 7: NEW HOME SALES



GRAPH 8: EXISTING SINGLE-FAMILY HOME SALES



GRAPH 9: HOME PRICES



## REGIONAL DATA

### Housing Starts

Not surprisingly, the mild weather during December and January had its greatest effect on housing starts in the Northeast, which shot up by 51.8 percent in January to a seasonally adjusted annual rate of 296 thousand units. While frozen ground and freezing temperatures generally slow construction, two months of temperatures in the high 30s and low 40s allowed developers in the Northeast to get a jump on their Spring construction. Although the January rate was the fastest seen since February of last year, it was still 10.3 percent slower than the January 1988 pace, when houses were started at an annual rate of 330 thousand units. The South and the West also experienced increases in the rate of starts, rising 3.0 and 4.4 percent, respectively. In the South, the 616 thousand unit annual rate was 33.9 percent faster than a year ago, while in the West, the 449 thousand unit rate was 18.8 percent above the January 1988 rate. The Midwest was the only region to experience a decline, falling 3.8 percent to an annual rate of 332 thousand units. However, January housing activity in the Midwest was up 44.9 percent over the 223 thousand unit rate set a year earlier.

### New Home Sales

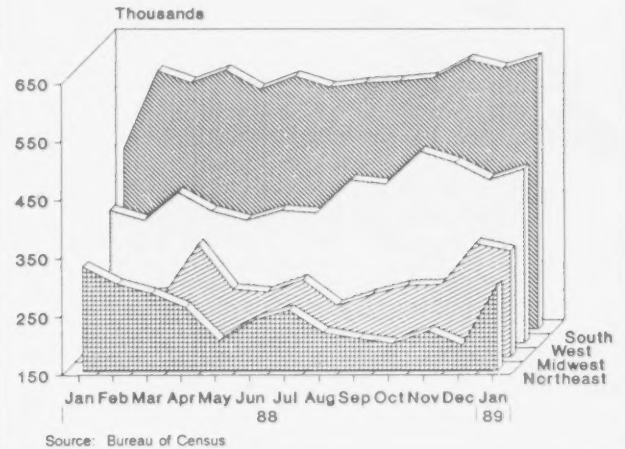
The moderate December increase in new home sales masked large swings occurring at the regional level. The greatest change took place in the Northeast, where sales jumped 52.9 percent to a seasonally adjusted annual rate of 104 thousand units. Moving in the opposite direction, sales in the Midwest fell 22.1 percent to an annual rate of 88 thousand units, putting sales at their slowest pace since May of 1987. In the West, sales fell by a modest 1.3 percent to a seasonally adjusted annual rate of 229 thousand units. Sales in the South dropped 2.0 percent to an annual rate of 248 thousand units. Over the course of 1988, sales grew in every region except the Northeast, where sales fell by 13.7 percent to a total of 101 thousand units. In the West, 1988 new home sales were up 9.6 percent to 204 thousand homes. In the Midwest and the South, sales grew by 1 percent with 98 thousand and 274 thousand units sold, respectively.

### Existing Home Sales

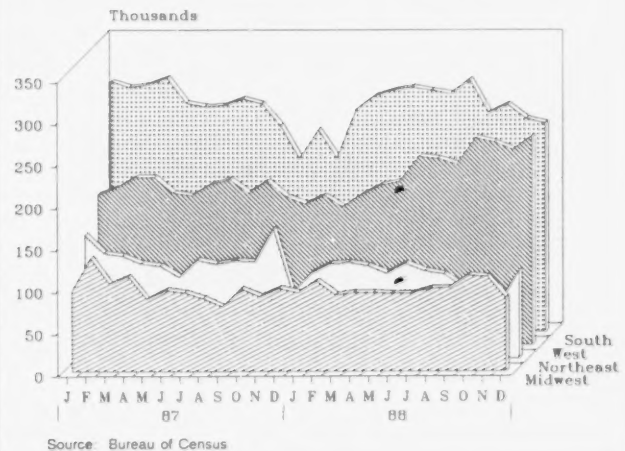
The rate of existing single family home sales dropped for every region except the Northeast during January. The largest decline came in the South where sales fell to 1.31 million units, or 12.6 percent below the December annual rate of 1.5 million units. In the Midwest, existing home sales slowed by 5.9 percent to an annual rate of 950 thousand units. Sales were down 8.6 percent in the West at an annual rate of 640 thousand units, a rate 23.1 percent faster than a year ago. Sales increased in the Northeast by a modest 1.4 percent to an annual rate of 710 thousand units.

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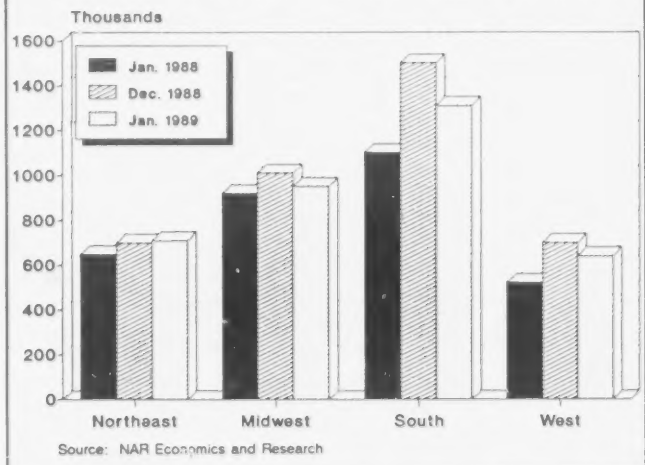
GRAPH 10: HOUSING STARTS BY REGION



GRAPH 11: NEW HOME SALES BY REGION



GRAPH 12: EXISTING HOME SALES BY REGION



## PRESIDENT BUSH'S BUDGET PROPOSALS AND HOUSING

### OVERVIEW

President Bush presented a \$1.6 trillion budget which overall is not much different from the Reagan Budget. The Budget proposes to keep the military budget at the level of inflation for one year and features selective spending increases and decreases in domestic programs. The most striking differences from the Reagan budget include proposals to reduce the taxation of capital gains, tax breaks for independent oil and gas drillers, enterprise zone tax incentives, and a reduction in the growth in Medicare payments.

The housing sector may be affected by changes in the budget in a variety of ways. The discussion below highlights proposals which have either a direct or indirect influence on the housing sector.

### PREFERENTIAL TREATMENT OF CAPITAL GAINS FOR INDIVIDUALS

The budget proposes restoring a capital gains tax differential on gains from qualified assets sold by individual taxpayers. This proposal reflects the Presidents belief that lower capital gains rates will stimulate investment and economic growth and create additional jobs. It is expected that the lower capital gains rate will increase capital gains realizations significantly in the short run, and lead to increased economic growth in the long run. Thus, receipts are expected to increase due to this proposal. The Administration anticipates a \$4.8 billion increase in receipts for fiscal year 1990. Other motivations for this proposal include the desire to correct for the taxation of purely inflationary gains, to reduce the tax bias toward debt finance, and to promote U.S. international competitiveness.

#### The Proposal

Specifically, under the proposal, individuals are allowed to exclude 45 percent of qualifying capital gains. For individuals with marginal income tax rates of 28 percent, or 33 percent, a 15 percent maximum tax rate will apply to qualified capital gains. Low income taxpayers (married taxpayers with adjusted gross income (AGI) below \$20,000 and single taxpayers with AGI below \$10,000) are allowed a 100 percent exclusion of gains on qualified assets.

In order to be eligible for preferential treatment, qualified capital assets must be held for at least 12 months if sold between June 30, 1989 and the end of calendar year 1992; 24 months if sold between 1993 and 1994; and 36 months if sold in 1995 or later.

The proposal retains the current law definition of a capital asset. However, certain assets are excluded from preferential treatment. These include (1) buildings, equipment, or other depreciable property if

such assets are used in a trade or business (including intangible assets subject to amortization), (2) depletable property if used in a trade or business, and (3) "collectibles" of a type in which IRAs cannot invest (e.g., works of art, antiques, stamps, and certain coins). In addition "special section 1231 assets" which include certain interests in timber, coal, iron ore, and livestock are ineligible for the reduced capital gains tax. The proposal does allow preferential treatment for gains on nondepreciable property that is used in a trade or business unless held for sale in the ordinary course of business. The proposal does not affect the treatment of gain on sale of a principal residence. Generally the gain is excluded from taxation due to the rollover provision and the \$125,000 exclusion provision under current law.

#### Implications for the Real Estate Sector

The proposal excludes buildings but includes land (unless the individual is a dealer) used in a trade or business. Theoretically, this proposal could affect the real estate sector in at least two major ways. First, since the proposed change, if enacted, could reduce the return from real estate relative to other assets (such as stocks), investment in real estate could tend to decline since it becomes less attractive. Second, such a change might bias the intensity of land development since land is given preferential treatment while structures are not. In general, a proposal which taxes structures more heavily than land is not considered good economic policy unless the objective is to slow down land development and reduce structural density.

#### Other Implications

The proposed differential would reduce the cost of capital relative to labor. To the extent that there is a strong substitution effect, employment will not rise as much, and/or wages may not rise as much relative to a situation where the differential tax treatment did not exist.

The proposal provides greater incentive to convert ordinary income to capital gains. Thus, taxpayers will find it beneficial to switch from assets which yield high dividend and low capital gains to assets which yield low dividends and high capital gains, since dividend income is taxed at ordinary income tax rates, while capital gains income would be taxed at a lower rate, under the proposal. Workers would attempt to benefit from the proposed reduction in the capital gains tax rate by receiving some of their wages and salary income in the form of incentive stock options. This behavior would also change the relative prices of assets, with tax preferred assets rising in price relative to non-tax preferred assets.

However, if the main concern of this type of proposal is to stimulate investment and economic growth, it is better to reduce the tax rate on income from capital than to reduce the tax rate on income from the gains from capital.

#### **ENTERPRISE ZONE TAX INCENTIVES**

The budget also includes a proposal for enterprise zones to encourage private industry investment and job creation in economically distressed areas. Enterprise zones are expected to lead to the revitalization of economically distressed areas by removing regulatory and other barriers inhibiting growth, and employment and tax incentives. The President advocates "creative partnerships" between government and the private sector to increase the opportunity for economically distressed areas and encourages states to join with the Federal Government by extending their own incentives and regulatory relief in enterprise zones.

Under the proposal, up to 70 zones will be selected between 1990 and 1993 to receive unspecified employment and tax incentives, and regulatory relief. The tax incentives would be both capital-based and employment-based, leading to estimated revenue losses of \$150 million in 1990 and totalling to \$1.05 billion over four years. The subsidy for a given enterprise zone would be larger in the early years, declining over time. The states' and localities' willingness to match Federal incentives are considerations which would affect the selection of the enterprise zones.

#### **HOMELESSNESS**

The President is proposing a new initiative for the homeless in addition to fully funding the McKinney Act. The budget proposes funding the McKinney Act up to the authorized level of \$746 million. This includes \$676 million of discretionary funding for programs to provide emergency food and shelter, transitional and permanent housing, and other needed services.

Moreover, a new \$50 million initiative proposed by Bush is designed to (1) help homeless families and children move out of welfare hotels and into transitional or permanent housing, (2) provide a coordinated package of services and shelter for the homeless mentally ill, and (3) make resources available on a flexible basis for communities to meet specific needs of homeless people in their areas. The details of this plan have not yet been disclosed, but the budget document indicates that states and localities would have much discretion in helping the homeless once selected. The selection would be on a competitive basis and requires matching funds.

President Bush's budget also includes other programs to help the homeless, including HUD efforts to provide funds for construction of permanent housing specifically to meet the needs of the mentally ill and elderly. In total, the 1990 budget includes over \$1 billion for the homeless.

#### **VETERANS HOUSING**

President Bush does not incorporate the Reagan proposal to raise the fee charged on the Department of Veterans Affairs (VA) guaranteed housing loans and vendee loans from the current 1 percent to 3.8 percent of the mortgage amount (vendee loans are direct loans made to both veterans and non-veterans who purchase property that the VA has acquired through prior defaults).

#### **CREDIT REFORM**

President Bush supports recent legislation proposed by Reagan to change the budgetary treatment of credit programs to attempt to measure a subsidy cost of direct loans and loan guarantees and to require appropriations for these costs. Office of Management and Budget (OMB) believe there is a subsidy involved in direct loans or loans guaranteed by the Federal government either because the government provides a lower interest rate, or because it guarantees or grants loans to those who would not be able to borrow at all or would be subject to higher interest rates in the private market. Note, that this proposal would have no effect on the deficit.

##### **Current Budget Treatment**

Under current budget treatment, the full amount of a direct Federal loan is treated as an outlay when the loan is made, then interest and principal repayments are shown as offsetting collections in later years. For loan guarantees, any initial premium shows up as an offsetting collection when the loan is made, and no cost is shown in subsequent years unless there is a default. Under the Reagan/Bush proposal, this theoretical cost of the lending programs would be estimated.

##### **Proposed Calculation Method**

The Reagan Administration proposed to estimate these subsidy costs by calculating the present value of the cash flow from Federal loans and loan guarantees using comparable private sector internal rates of return. In the original draft bill, the Administration had proposed that newly made direct loans be sold immediately and competitively to measure these subsidy costs. It also proposed that reinsurance for loan guarantees be gradually phased-in as the market for reinsurance developed.

##### **Current Budget Status**

President Bush has not yet put forth the specific line item details of his budget, but under the Reagan Budget, the housing sector is projected to account for \$75 billion or 60 percent of all new direct and guaranteed loan commitments in 1990. The Reagan Administration estimated the credit cost to housing at over \$3 billion. The credit cost to housing is projected to be 34 percent of loan credit cost to all sectors.

The National Association of REALTORS® has expressed their concerns over the Credit Reform Proposal to OMB policymakers stating that the proposal, if enacted, would tend to worsen housing affordability; would legislatively define "subsidy" in a way inconsistent with common usage and create the false appearance that self-supporting programs, such as the Federal Housing Administration (FHA) Mutual Mortgage Insurance Fund and the Government National Mortgage Association (GNMA) mortgage-backed securities guarantee program, are subsidized. The NAR position also points out that the proposal would discriminatorily apply this definition *only* to government credit activities and would introduce very complex decision mechanisms resulting in uncertainty about the availability of housing credit.

#### HOUSING CREDIT AND USER FEES

The Bush proposal changes the Reagan proposal on housing credit fees *only* by deleting the VA housing origination fee increase. In general his budget approach is to start from the FY 1989 actual spending amounts and propose selective departures from those amounts as necessary or as he considers important. This would preserve a portion of the \$81.5 billion increase in revenues from FY 1989 to 1990, for deficit reduction.

The Reagan Budget proposed levying user fees on a number of government-sponsored enterprises (including the Federal Home Loan Mortgage Corporation) in order to reduce or eliminate their competitive advantage. The Reagan Administration proposed to raise the fee paid to the Government National Mortgage Association (GNMA) for guaranteeing mortgage-backed securities. The fee would be raised from 6 basis points to 10 basis points by 1991 and to 15 basis points by 1992. The previous Administration also proposed a similar fee increase for the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation.

The Federal government imposes credit limits on new loan commitments guaranteed by GNMA or insured by the FHA. GNMA supports the mortgage market by guaranteeing mortgage-backed securities that are issued by private lenders and backed by mortgages insured by the FHA or guaranteed by VA. For 1990, the Reagan Administration proposed a new commitment limitation of \$75 billion on GNMA guarantees and \$67 billion on FHA guarantees. At this writing, these limitations are not expected to be binding, since the Administration estimated that new commitments under both GNMA and FHA are \$66 billion and \$59 billion - below the limitation amounts. The specific line item details of President Bush's Budget have not yet been revealed, but he has proposed no change in these amounts for Fiscal Year 1990.

The Association's current position on the proposed fee increases and the credit authority limitations are that the proposed "user fees" would far exceed these programs' costs amounting to a tax on housing; and the credit authority limitations proposed for FHA Mutual Mortgage Insurance and for GNMA are adequate to support the volume of market activity that is anticipated.

#### OTHER HOUSING PROPOSALS

Other Reagan proposals include replacement of Section 202 direct loans (for rental or cooperative housing facilities for the elderly or handicapped) with \$78 million in credit vouchers, and continuation of the 1988 rural housing voucher initiative operated jointly by the Department of Housing and Urban Development (HUD) and the Farmers Home Administration (FmHA). Bush endorses Reagan's proposed 20,000 rural housing vouchers to be funded by FmHA, and \$100 million in direct loans for multi-family housing construction targeted to areas experiencing housing shortages.

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## U.S. ECONOMIC OUTLOOK

MARCH 1989

|                                                                                                                 | QUARTERS |        |          |        |        |        |        |        | YEARS  |        |          |        |        |
|-----------------------------------------------------------------------------------------------------------------|----------|--------|----------|--------|--------|--------|--------|--------|--------|--------|----------|--------|--------|
|                                                                                                                 | ACTUAL   |        | FORECAST |        |        |        |        |        | ACTUAL |        | FORECAST |        |        |
|                                                                                                                 | 88.3     | 88.4   | 89.1     | 89.2   | 89.3   | 89.4   | 90.1   | 90.2   | 1986   | 1987   | 1988     | 1989   | 1990   |
| <b>AGGREGATE ECONOMY</b>                                                                                        |          |        |          |        |        |        |        |        |        |        |          |        |        |
| Gross National Product<br>(billions of dollars)                                                                 | 4909     | 4995   | 5106     | 5189   | 5266   | 5345   | 5430   | 5504   | 4240   | 4527   | 4863     | 5226   | 5545   |
| % Change                                                                                                        | 7.3      | 7.2    | 9.1      | 6.7    | 6.1    | 6.1    | 6.5    | 5.6    | 5.6    | 6.8    | 7.4      | 7.5    | 6.1    |
| % Change (w/out inflation)                                                                                      | 2.5      | 2.0    | 5.0      | 2.6    | 2.2    | 2.1    | 1.8    | 1.4    | 2.8    | 3.4    | 3.8      | 3.0    | 1.9    |
| Consumer Price Inflation (CPI)                                                                                  | 4.8      | 4.4    | 5.3      | 5.0    | 4.7    | 4.9    | 5.4    | 5.2    | 1.9    | 3.7    | 4.1      | 4.9    | 5.1    |
| GNP Inflation (GNP Deflator)                                                                                    | 4.7      | 5.3    | 3.8      | 3.9    | 3.9    | 3.9    | 4.7    | 4.1    | 2.7    | 3.3    | 3.4      | 4.4    | 4.2    |
| Unemployment Rate - Civilian                                                                                    | 5.5      | 5.3    | 5.3      | 5.3    | 5.2    | 5.2    | 5.2    | 5.4    | 7.0    | 6.2    | 5.5      | 5.3    | 5.4    |
| Civilian Employment-Household Basis (millions)                                                                  | 115.2    | 115.8  | 116.9    | 117.4  | 118.0  | 118.4  | 118.8  | 119.0  | 109.6  | 112.4  | 115.0    | 117.7  | 119.2  |
| Percent change                                                                                                  | 2.0      | 2.2    | 3.6      | 2.0    | 1.8    | 1.6    | 1.2    | 0.8    | 2.3    | 2.6    | 2.3      | 2.3    | 1.3    |
| Index of Industrial Production                                                                                  | 138.4    | 140.0  | 141.2    | 141.8  | 142.6  | 143.4  | 143.8  | 144.0  | 125.1  | 129.8  | 137.2    | 142.2  | 144.3  |
| Manufacturing Capacity Utilization                                                                              | 84.0     | 84.4   | 84.8     | 85.0   | 85.0   | 84.9   | 84.8   | 84.7   | 79.7   | 81.0   | 83.6     | 84.9   | 84.5   |
| Domestic Auto Sales                                                                                             | 7.6      | 7.5    | 6.8      | 7.5    | 7.1    | 7.3    | 7.3    | 7.2    | 8.2    | 7.1    | 7.5      | 7.2    | 7.1    |
| Federal Tax Receipts (NIPA) as % of GNP                                                                         | 19.9     | 19.8   | 20.0     | 20.2   | 20.3   | 20.4   | 20.8   | 20.7   | 19.5   | 20.2   | 20.0     | 20.2   | 20.7   |
| Federal Expenditures (NIPA) as % of GNP                                                                         | 22.4     | 23.0   | 23.0     | 22.9   | 22.8   | 22.8   | 23.0   | 23.0   | 24.4   | 23.7   | 23.0     | 22.9   | 23.0   |
| Deficit (NIPA) as % of GNP                                                                                      | -123.5   | -160.9 | -152.9   | -136.3 | -133.6 | -130.4 | -119.1 | -123.2 | -205.6 | -157.8 | -143.2   | -138.3 | -124.9 |
|                                                                                                                 | -2.5     | -3.2   | -3.0     | -2.6   | -2.5   | -2.4   | -2.2   | -2.2   | -4.9   | -3.5   | -2.9     | -2.6   | -2.3   |
| <b>REAL ESTATE MARKETS</b>                                                                                      |          |        |          |        |        |        |        |        |        |        |          |        |        |
| <b>HOME SALES</b>                                                                                               |          |        |          |        |        |        |        |        |        |        |          |        |        |
| Total Single-family Home Sales<br>(thousands, single-family resales plus<br>97 percent of single-family starts) | 4692     | 4868   | 4643     | 4590   | 4679   | 4483   | 4292   | 4382   | 4712   | 4648   | 4649     | 4599   | 4332   |
| Percent change - year ago                                                                                       | 3.6      | 9.5    | -2.0     | -1.7   | -0.3   | -7.9   | -7.6   | -4.5   | 10.8   | -1.4   | 0.0      | -1.1   | -5.8   |
| Existing Single-family Home Sales (thousands)                                                                   | 3663     | 3770   | 3560     | 3590   | 3680   | 3490   | 3305   | 3410   | 3565   | 3526   | 3594     | 3580   | 3347   |
| Percent change - year ago                                                                                       | 6.8      | 11.2   | 7.9      | -1.5   | 0.5    | -7.4   | -7.2   | -5.0   | 10.9   | -1.1   | 1.9      | -0.4   | -6.5   |
| Housing Starts (thousands)                                                                                      | 1467     | 1556   | 1544     | 1433   | 1433   | 1420   | 1415   | 1396   | 1812   | 1634   | 1495     | 1458   | 1413   |
| Percent change - year ago                                                                                       | -9.4     | 1.5    | 4.6      | -3.2   | -2.3   | -8.7   | -8.4   | -2.6   | 4.1    | -9.8   | -8.5     | -2.5   | -3.0   |
| Single-Family Units                                                                                             | 1061     | 1132   | 1117     | 1031   | 1030   | 1024   | 1018   | 1002   | 1183   | 1157   | 1088     | 1051   | 1015   |
| Percent change - year ago                                                                                       | -8.1     | 3.9    | 1.8      | -2.9   | -2.9   | -9.5   | -8.8   | -2.9   | 10.4   | -2.2   | -5.9     | -3.4   | -3.4   |
| Multi-Family Units                                                                                              | 406      | 423    | 428      | 402    | 403    | 396    | 397    | 395    | 630    | 477    | 407      | 407    | 398    |
| 2-4 Family Units                                                                                                | 57       | 66     | 66       | 62     | 63     | 61     | 62     | 61     | 85     | 66     | 59       | 63     | 62     |
| Percent change - year ago                                                                                       | 3.0      | 16.6   | 17.8     | 8.7    | 9.7    | -6.6   | -7.2   | -1.8   | -9.0   | -22.6  | -10.1    | 6.9    | -2.2   |
| 5+ Family Units                                                                                                 | 349      | 358    | 361      | 340    | 341    | 334    | 336    | 333    | 545    | 412    | 348      | 344    | 336    |
| Percent change - year ago                                                                                       | -14.7    | -7.5   | 11.7     | -5.9   | -2.4   | -6.5   | -7.2   | -1.8   | -5.6   | -24.4  | -15.5    | -1.1   | -2.2   |
| New Single-family Home Sales (thousands)                                                                        | 703      | 685    | 673      | 657    | 660    | 590    | 570    | 585    | 750    | 671    | 677      | 645    | 585    |
| Percent change - year ago                                                                                       | 4.1      | 10.3   | 6.8      | -5.7   | -6.1   | -13.9  | -15.3  | -11.0  | 9.0    | -10.5  | 0.9      | -4.7   | -9.3   |
| <b>HOME PRICES</b>                                                                                              |          |        |          |        |        |        |        |        |        |        |          |        |        |
| Existing Home Prices - Median \$(1000)                                                                          | 90.1     | 88.3   | 91.4     | 93.3   | 95.2   | 95.9   | 96.2   | 98.1   | 80.3   | 85.6   | 89.3     | 94.0   | 99.1   |
| Percent change - year ago                                                                                       | 5.4      | 3.9    | 4.1      | 4.9    | 5.7    | 8.6    | 5.3    | 5.1    | 6.4    | 6.6    | 4.3      | 5.2    | 5.5    |
| New Home Prices - Median \$(1000)                                                                               | 114.9    | 114.9  | 115.6    | 117.9  | 119.4  | 120.4  | 121.0  | 123.4  | 92.0   | 104.0  | 112.5    | 118.3  | 125.0  |
| Percent change - year ago                                                                                       | 8.2      | 2.8    | 2.4      | 4.4    | 3.9    | 4.8    | 4.7    | 4.7    | 9.1    | 12.9   | 8.2      | 5.2    | 5.6    |
| <b>FINANCIAL MARKETS</b>                                                                                        |          |        |          |        |        |        |        |        |        |        |          |        |        |
| <b>Long-Term Interest Rates</b>                                                                                 |          |        |          |        |        |        |        |        |        |        |          |        |        |
| 30-year FRM (FHA Secondary)                                                                                     | 10.7     | 10.6   | 10.8     | 11.2   | 11.3   | 11.3   | 11.2   | 10.9   | 9.9    | 10.2   | 10.5     | 11.1   | 10.7   |
| 1-year ARM (without buydown)                                                                                    | 8.3      | 8.5    | 8.8      | 9.2    | 9.2    | 9.0    | 8.7    | 8.6    | 9.5    | 8.5    | 8.5      | 9.0    | 8.6    |
| Corporate AAA Bond Rate                                                                                         | 10.0     | 9.5    | 9.9      | 10.0   | 10.2   | 10.2   | 10.2   | 10.0   | 10.0   | 9.4    | 9.7      | 10.1   | 9.9    |
| Government Bond Rate                                                                                            | 9.2      | 9.0    | 9.1      | 9.3    | 9.5    | 9.6    | 9.6    | 9.3    | 7.8    | 8.6    | 9.0      | 9.4    | 9.4    |
| <b>Short-Term Interest Rates</b>                                                                                |          |        |          |        |        |        |        |        |        |        |          |        |        |
| Federal Funds Rate                                                                                              | 8.0      | 8.5    | 9.5      | 10.0   | 9.8    | 9.5    | 9.0    | 8.8    | 6.8    | 6.7    | 7.6      | 9.7    | 8.8    |
| 3-month T-Bill Rate                                                                                             | 7.0      | 7.7    | 8.5      | 8.9    | 8.8    | 8.5    | 8.0    | 7.8    | 6.0    | 5.8    | 6.7      | 8.7    | 7.8    |
| Prime Rate                                                                                                      | 9.7      | 10.2   | 11.0     | 11.7   | 11.5   | 11.3   | 10.8   | 10.4   | 8.3    | 8.2    | 9.3      | 11.4   | 10.4   |
| Discount Rate                                                                                                   | 6.3      | 6.5    | 6.7      | 7.0    | 7.0    | 6.9    | 6.8    | 6.6    | 6.3    | 5.7    | 6.2      | 6.9    | 6.6    |
| Value of the U.S. Dollar (Trade-Weighted Avg.)                                                                  | 97.6     | 93.0   | 94.6     | 93.6   | 91.1   | 88.0   | 86.0   | 84.0   | 112.3  | 96.9   | 92.8     | 91.8   | 84.5   |
| Percent change                                                                                                  | 35.6     | -17.6  | 7.2      | -4.2   | -10.1  | -13.2  | -8.5   | -9.0   | -21.6  | -13.6  | -4.3     | -1.0   | -8.0   |

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.  
Assumptions and simulations by Dr. John Tuccillo, Dr. Frederick Flick, Sean Burns and Beth Maerz.



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